Core Services Category: Employer Pension Contribution

Study Area: Extension of FY10/FY11 Solvency Measure

High Level Recommendation: Postpone the sixth 0.75 percentage incremental increase in employer contributions to the Educational Retirement Board (ERB) currently scheduled for July 1, 2011 (FY12) for one year to July 1, 2012 (FY13); add the seventh and final 0.75 percentage increase on July 1, 2013 (FY14).

This bill must pass in order to avoid incurring an $18.3 million expense to the general fund.

Problem Statement: Laws 2005, Chapter 273 implemented a schedule of employee and employer contribution increases to improve the funded status of the ERB fund, including a seven-year annual incremental increase of 0.75 percent for ERB employers ending at a final rate of 13.9 percent in FY12. It should be noted that Senate Bill 181, as originally drafted, implemented a four-year schedule of 0.75% increases ending at in FY09 at 11.65 percent. This additional 3 percent employer contribution, going from 8.65 percent to 11.65 percent, met ERB's actuarial recommendation designed to address solvency concerns at that time. A House Floor Amendment increased the schedule an additional three years to a final 13.9 percent, presumably to add a "cushion" for the educational plan to improve funded status.

Table 1 – Laws 2005, Chapter 273 (Senate Bill 181)

Fiscal year	Employee Contribution Rate	Employer Contribution Rate	Incremental Change in Employer Rate
FY05	7.6%	8.65%	
FY06	7.675%	9.4%	0.75%
FY07	7.75%	10.15%	0.75%
FY08	7.825%	10.9%	0.75%
FY09	7.9%	11.65%	0.75%
FY10	7.9%	12.4%	0.75%
FY11	7.9%	13.15%	0.75%
FY12	7.9%	13.9%	0.75%

Each year's increase represented an aggregate fiscal impact of about $18.3 million general fund appropriations needed by ERB-affiliated employers to pay the additional contribution. Due to reduced state revenues, Laws 2010, Chapter 67 (Senate Bill 91) postponed the 0.75 percent increase slated for FY11 until FY12 to help balance the state budget as part of a package of solvency measures. A projected budget deficit for FY12 requires careful consideration of continuing FY10/FY11 solvency measures, including delaying the 0.75 ERB employer increase an additional year until FY13 (July 1, 2012).

Background and Findings: Section 22-11-21 NMSA 1978 lays out the employee and employer contributions for ERB. The current rates are summarized in Table 2. Note that the rates also reflect the impact stemming from another solvency measure – Laws 2009, Chapter 127 – that increased the employee rate by 1.5 percent and correspondingly reduced the employer rate by 1.5 percent for those employees making more than $20,000.

Table 2 – Current Statutory Contribution Rates

Employee Contributions		Normal	FY10	F11	FY12	FY13
<$20,000		7.90%	7.90%	7.90%	7.90%	7.90%
>20,000		7.90%	9.40%	9.40%	7.90%	7.90%
Swap	1.50% FY10/FY11 for employees>$20,000				End 1.5%	
Employer Contributions		**Normal**	**FY10**	**F11**	**FY12**	**FY13**
<$20,000			12.40%	12.40%	13.15%	13.90%
>20,000			10.90%	10.90%	13.15%	13.90%
Swap	1.50% FY10/FY11 for employees>$20,000				End 1.5%	
Increase	0.75% Delayed from FY11 to FY12				Add 0.75%	Add 0.75%

Current statutory rates complete the final 13.9 percent employer contribution in FY13, one year later than originally planned. This proposal would extend the final phase another year to FY14 as shown in Table 3.

Table 3 – Contribution Rates Under the Proposal

Employee Contributions		Normal	FY10	F11	FY12	FY13	FY14
<$20,000		7.90%	7.90%	7.90%	7.90%	7.90%	7.90%
>20,000		7.90%	9.40%	9.40%	7.90%	7.90%	7.90%
Swap	1.50% FY10/FY11 for employees>$20,000				End 1.5%		
Employer Contributions		**Normal**	**FY10**	**F11**	**FY12**	**FY13**	**FY14**
<$20,000			12.40%	12.40%	12.40%	13.15%	13.90%
>20,000			10.90%	10.90%	12.40%	13.15%	13.90%
Swap	1.50% FY10/FY11 for employees>$20,000				End 1.5%		
Increase	0.75% Delayed from FY12 to FY13				DELAY	Add .75%	Add .75%

Prior actuarial analysis indicated that the impact to the fund due to delaying the 0.75 percent increase scheduled for FY11 to FY12, primarily resulting from the lost opportunity cost of not having the additional contributions invested, would be minimal.

Options to Consider:
Option 1: Delay the 0.75 percent increase from FY12 to FY13 to save about $18.3 million in general fund appropriations to public education and higher education entities.
Option 2: Schedule the final 1.5 percent increase over a longer period of time, such as the six years being considered by the Retirement System Solvency Task Force.
Option 3: Keep the statutory rates as currently scheduled and budget accordingly.

Fiscal Implications: Based on FY10 appropriations, table 4 shows the estimated fiscal impact for each incremental 0.75 percent contribution for employers.

Table 4 – Estimated Fiscal Impact of Each 0.75% Employer Contribution Increase

Public School Support*	(in thousands)
Program Costs	$12,073.2
Transportation	$194.8
Higher Education**	$6,024.0
TOTAL	$18,292.0

*Source: Public Education Department
**Source: Laws 2009, Chapter 124, p 188

If this or a similar bill does not pass, the increased contribution represents an $18.3 million expense to the general fund.

The prior ERB analysis performed as part of the agency response for Senate Bill 91 during the 2010 session estimated a reduction in the fund's market value of assets by $177 million on a projected total fund value of $17.4 billion by 2030. The Fiscal Impact Report notes the following actuarial impact of a one-year delay:

Actuarial Impact of One-Year Delay
Table 2 shows the projected impact of delaying the employer contribution increase on actuarial solvency measures, the funded ratio (actuarial value of assets compared to the actuarial value of liabilities) and funding period (the amount of time estimated to pay off the unfunded liability). The impact appears deminimus.

Table 2 – Impact on Actuarial Solvency Measures*

Fiscal Year	**Without One-Year Delay**		**With One-Year Delay**	
	Funded Ratio	**Funding Period**	**Funded Ratio**	**Funding Period**
FY10	67.3%	48.7	67.3%	48.7
FY11 (delay)	63.3%	55.1	63.3%	94.3
FY12	59.3%	61.5	59.1%	infinite
FY13	54.9%	infinite	54.6%	infinite
FY24	53.5%	infinite	53%	infinite
FY25	53.6%	113.8	53.1%	186.4
FY38	61%	34.2	60.3%	35.6

*Source: ERB (based on the June 30,2009 valuation)

Minimum industry standards require 80 percent for the funded ratio and 30 years for the funding period. The bill's impact primarily influences the funding period, extending the fund's infinite funding status by one year in FY12. In both cases the indicators fall substantially below industry standards, portraying a situation where the obligations promised to current retirees and active members are being pushed out to future generations to fulfill. Delaying the employer contribution increase for one year will not substantially alter this picture. However, deviations from assumptions, such as over or under performing the 8 percent assumed rate of investment return, could materially impact this dynamic.

The actuarial impact of delaying the increased contribution another year under the proposal has not been performed. However, preliminary actuarial measures indicate ERB's FY10 investment return of 18.2 percent improved the funding period projections and it is reasonable to assume that another year delay would have a similar deminimus actuarial impact.

Option 2 would spread out the cost of the incremental increase over more time, reducing the amount at the state would need to allocate each year. A six year schedule would require an approximate $3 million general fund expense for each of year.

Option 3 will require an estimated $18.3 million expense to the general fund.

Implementation Plan: Options 1 and 2 would require legislation to amend Section 22-11-21 NMSA 1978 to implement the rate changes. Option 3 would not require any further action.

Various stakeholders may view the delay as a breach of the state's 2005 promise to increase the employer contribution rate to improve ERB fund solvency and question any proposed reductions to benefits for fund solvency by members as unfair until the state "makes good" on its promise. An actuarial study that shows the impact on fund solvency of a two-year delay in fulfilling the 2005 legislation may be necessary to show the impact as being minimal and that fund solvency requires additional measures to reduce plan cost to ensure fund solvency.